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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 189

BENJAMIN B. FOSTER AND ROBERT R. TODD, EXECUTORS OF THE ESTATE OF ANNA FOSTER FORD, DECEASED,
Petitioners,

vs.

THE UNITED STATES.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

REPLY BRIEF FOR THE PETITIONER.

R. KEMP SLAUGHTER.
HUGH C. BICKFORD.

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The brief of respondent does not base its argument upon the statute nor upon the decided cases, none of which are discussed, or even cited, and all of which are contrary to the decision of the court below. What respondent attempts to do is draw an inference, not from the statute, but from the words of the House Committee referring to another proposition. On this basis counsel contends that the whole of a liquidating dividend must be charged against capital account and, as a necessary corollary, that none of it be charged against earnings and profits. This conclusion is contrary to what the Congressional Committees said, is

impossible under the plain words of the statute, and is not, really, what the court below decided.

As to the Committee report quoted by respondent on pages 6 and 7, it will clearly be seen that the Committee in the portion of its report quoted was referring not to the last sentence of Section 115 (c), with which we are concerned, but was referring to the first and second sentences of that subdivision which provided that amounts received by the stockholder "shall be treated as in part or full payment in exchange for the stock. The gain or loss *to the distributee* resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112." In other words, the stockholder should treat the profit or loss as one from a sale of goods and not as a dividend subject only to surtaxes. Dealing with this proposition the House Committee said that "from the viewpoint of the stockholder" it is to be treated as a return of his capital. Thus used, the quoted phrase "from the viewpoint of the stockholder" is really one of limitation which limits the effect of the part of the section there discussed only to the stockholder. If Congress has intended to say that the corporate accounts should also treat the whole distribution as a charge against the paid-in capital account it would have said so; it would not have carefully limited the application only to the stockholder. But, as pointed out, the Committee was there referring only to the *manner* of taxing the receipt in the hands of the stockholder. When it discussed the effect of the distribution upon the capital and earnings of the distributor, the corporation,—in the very same report—the Committee said:

> "Since distributions out of *earnings* * * * and distributions out of *capital* are in some instances treated differently it is material to know the source of a given distribution, even though all earnings and profits accumulated since February 28, 1913, have been

distributed. Consequently, in section 201 (b) the presumption that *every* distribution is out of earnings and profits applies to *all earnings and profits, whether accumulated prior or subsequent to March 1, 1913.*" (Senate Report No. 398, 68th Cong., 1st Sess., p. 11.) (Italics added.)

Thus, when the Committee talks about the point involved in this case (the effect upon the corporate accounts) the Committee expressly draws the exact distinction between "capital" and "all earnings and profits, whether accumulated prior or subsequent to March 1, 1913."

As to the statute, the respondent's position that none of the liquidating distribution was a distribution out of earnings or profits (p. 9) is clearly untenable. Repeating what was said in the original brief, Section 115 (c) states that the "part" which is charged to capital account "*shall not*" be considered "earnings or profits" under subdivision (b). Subdivision (b) defines earnings and profits as including earnings both before and after March 1, 1913. If the capital account included all of the liquidating dividend, as counsel contends, then to charge *any* of it against earnings "whether accumulated prior or subsequent to February 28, 1913," would be directly contrary to the words of the statute. Yet counsel asks that this be done when he contends that the surplus distributed be charged against earnings prior to March 1, 1913. As said in the original brief, it is only by construing the term "capital account" as synonomous with "paid-in capital", according to recognized accounting practice, that the section can be sensibly and logically applied. The balance of the distribution would then be charged against earnings and profits "within the meaning of subsection (b)". The "meaning of subsection (b)" requires the charge to be made against the most recently accumulated earnings until exhausted and then against the "earnings or profits" prior to March 1, 1913.

A further point to consider in determining whether Congress referred to the stockholder or to the corporation when it said "the amount chargeable to capital account" is to consider the use of the word "*chargeable*". In accounting parlance, as well as in the ordinary usage of language, a "charge", or something that is "chargeable", is an item of outgo or expense, something paid out or charged against assets. Income or receipt is always referred to as a "credit" and is "credited." Only the corporation would consider money *paid out* in retirement of stock, as a charge or chargeable to its capital account. The stockholder would naturally consider the receipt of such money as a credit and would "credit" it to his capital account, not charge it thereto. Accordingly, when Congress uses the term "chargeable", it necessarily referred to the treatment on the books of the payor, the corporation.

The Court below similarly holds that the whole distribution is "capital" and, therefore, that none of it should be charged to "earnings or profits". But the Court then proceeds to charge it against earnings prior to 1913, precisely what the statute prohibits.

On page 10 of his brief the Respondent concludes with the statement that the question is unimportant, immediately after having said that he disagrees with the Board's contrary decision in the *Craig* case and will take an appeal therein.* The *Craig* case involves only $363, much less than it will cost the respondent to prosecute his appeal. Apparently, in that case, the respondent considers the *Craig* case of great importance and is going to prosecute an appeal at a cost of much more than the amount involved to obtain what he conceives to be the proper decision, but here, he informs the Court the question "is of no general public interest or importance".

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* The appeal has now been taken.

It is apparent that the recent enactment of the Undistributed Profits Tax on Corporations, allowing deduction for dividends paid, causes the dividend question to be of even greater importance than in the past. There can be no doubt that conflict exists between the decision below and the decisions of other courts. We respectfully request that the petition be granted.

HUGH C. BICKFORD.
R. KEMP SLAUGHTER.

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